

March 28, 2013

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POINT 1

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JURISDICTIONAL STATEMENT

Pursuant to Sections 386.510 and 386.540, RSMo (Supp. 2012),¹ the Office of the Public Counsel (“OPC” or “Public Counsel”) appeals the Report and Order issued by the Missouri Public Service Commission (“Commission” or “PSC”) in Case No. GR-2008-0364. (Appendix, pp. A1–A33). The Western District of the Missouri Court of Appeals issued its opinion affirming the Commission’s Report and Order in this matter on September 18, 2012 in WD74714.² OPC moved the Western District to rehear the matter or alternatively transfer it to this Court. The Western District denied both motions.

¹ All statutory references are to Missouri Revised Statutes 2000 unless otherwise noted. Effective July 1, 2011, Sections 386.510 and 386.540, RSMo were amended with respect to Commission orders or decisions issued on and after July 1, 2011. The Commission’s Report and Order at issue herein was issued subsequent to that date, effective November 19, 2011. Hence the OPC appeal was filed directly with the Western District Missouri Court of Appeals.

² *Office of Public Counsel v. Missouri Public Service Com’n*, 2012 WL 4069548 (Sept. 18, 2012) (App. p. A52). The Missouri Court of Appeals has also reviewed substantially similar issues in a subsequent case involving Atmos’ gas purchases in 2008-2009. In the subsequent case, the Western District again affirmed the Commission’s decision under substantially similar facts and utilizing the same legal analysis. See *Atmos Energy Corp. v. Office of Public Counsel*, 389 S.W.3d 224 (Mo. App. W.D. 2012). (App. p. A60).

After OPC sought transfer of the case pursuant to Rule 83.04 of the Missouri Supreme Court Rules, this Court granted transfer on January 29, 2013. Jurisdiction is proper under Art. V, Sec. 10 of the Constitution of Missouri.

STANDARD OF REVIEW

“[T]he appellate standard of review of a PSC order is two-pronged: ‘first, the reviewing court must determine whether the order is lawful; and second, the court must determine whether the order is reasonable.’” *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm’n*, 120 S.W.3d 732, 734 (Mo. banc 2003) (quoting *State ex rel. Atmos Energy Corp v. Pub. Serv. Comm’n*, 103 S.W.3d 753, 759 (Mo. banc 2003)). “The lawfulness of a PSC Order is determined by whether statutory authority for its issuance exists, and all legal issues are reviewed *de novo*.” *AG Processing, Inc.*, 120 S.W.3d at 734. If the Commission’s order is found to be lawful, the reviewing court must then determine whether it is reasonable. A PSC order is reasonable ““where the order is supported by competent evidence on the whole record; the decision is not arbitrary or capricious [;] or where the [PSC] has not abused its discretion.”” *State ex rel. Praxair, Inc. v. Missouri Pub. Serv. Comm’n*, 344 S.W.3d 178, 184 (Mo. Banc 2011), quoting *Envtl. Utils., LLC v. Pub. Serv. Comm’n*, 219 S.W.3d 256, 265 (Mo. App. 2007).

A Commission order is presumed valid. *State ex rel. Office of Public Counsel v. Public Service Commission*, 289 S.W.3d 240, 246 (Mo. Ct. App. W.D. 2009). Challengers have the burden to prove it invalid. *Id.* The reviewing court will not substitute its judgment for that of the Commission on issues within the realm of the

Commission's expertise. *Id.* at 247. The determination of witness credibility is solely within the discretion of the Commission, which is free to believe none, part, or all of a witness's testimony. *State ex rel. Missouri Office of the Public Counsel v. Public Service Commission of Missouri*, 293 S.W.3d 63, 69 (Mo. App. S.D. 2009). The Commission is also afforded the benefit of reasonable inferences that may be drawn from the facts. *State ex rel. Noranda Aluminum, Inc. v. Public Service Commission of Missouri*, 356 S.W.3d 293, 297 (Mo. App. S.D. 2011).

STATEMENT OF FACTS

Respondent Atmos Energy Corporation (“Atmos” or “Company”) respectfully submits that OPC’s Brief violates Appellate Rule 84.04(c) calling for a statement of facts “without argument.” In accordance with Rule 84.04(f), Atmos provides its Statement of Facts to the Court.³

At the times relevant to this appeal, Atmos Energy Corporation operated in Missouri as a regulated natural gas local distribution company (LDC) providing retail natural gas service to approximately 65,500 residential and business customers in Missouri.⁴ A Gas Corporation and a Public Utility as defined by Missouri statute (Section 386.020(18) and (43), RSMo (Supp. 2012), respectively), Atmos is subject to the jurisdiction of Respondent Missouri Public Service Commission. (App. p. A21).

³ References to the Record on Appeal filed with the Western District Court of Appeals on January 30, 2012, by Respondent Missouri Public Service Commission:

“L.F.”: Legal File (Volumes I – VIII);

“Tr.”: Transcripts to Legal File (Volumes I – V);

“Ex.”: Exhibits (Volume I – VII);

“App.”: Appendix to the Substitute Brief of Respondent Atmos Energy Corporation;

⁴ Ex. 1, Buchanan Direct, pp. 3-6. In 2012, Atmos sold its assets in Missouri to Liberty Energy (Midstates) Corp. d/b/a Liberty Utilities. (MoPSC File No. GM-2012-0037). This Substitute Brief reflects the facts in the record and at the times relevant to this appeal.

As an LDC, Atmos obtains supplies of natural gas from natural gas producers and distributes that natural gas to homes and businesses within its service territory. Within Missouri, Atmos provides natural gas service to customers in three geographic areas: Northeastern, Southeastern, and Western. Within each area, Atmos serves customers through one or more operating systems. (App. p. A6).

Atmos holds long-term contracts with various interstate pipelines for natural gas storage and transportation capacity to supply the firm natural gas requirements of its Missouri service areas. (App. p. A7). Atmos does not produce its own natural gas and does not purchase that gas directly from producers. Instead, Atmos contracts with independent gas marketing companies to purchase the natural gas that is then flowed through the interstate pipeline using Atmos' pipeline capacity. (*Id.*).

In addition to its regulated operations as a LDC, Atmos also owns Atmos Energy Marketing, LLC (AEM), a separate, unregulated gas marketing company. (*Id.*).

The underlying PSC proceeding concerns the second phase of the two-phase Purchased Gas Adjustment (PGA)/ Actual Cost Adjustment (ACA) process. (App. p. A3). During the initial PGA phase, Atmos adjusted the rates it charged its customers to allow it to recover its varying costs of acquiring a supply of natural gas to serve those customers. Atmos had filed to amend the rates in its PGA tariff on May 15, 2008, and the PSC opened Case No. GR-2008-0364 to track the company's PGA factors to be reviewed in its 2007-2008 Actual Cost Adjustment (ACA) filing. (L.F. p. 1, L.F. p. 30). The PSC approved the various PGA rate changes proposed by Atmos during the ACA

period on an interim basis, subject to refund, pending final Commission decisions. (L.F. p. 30).

In the ACA phase of the process, the Commission examines Atmos' natural gas purchases to determine whether the rate the company charged its customers was correct and whether the decisions the company made regarding its gas purchases were prudent. (App. p. A4). Atmos submitted its 2007-2008 ACA filings on October 16, 2008, and on December 28, 2009, the Staff of the Commission filed its recommendation following completion of the audit of said ACA filing. (L.F. p. 170). The Staff's audit consisted of a review and analysis of the billed revenues and actual gas costs for the period of September 1, 2007 to August 31, 2008 for all areas of served by the Company in Missouri. Staff proposed disallowances relating to two of Atmos' operating systems during the course of this case. (*Id.*).

The first affected operating system is the Consolidated Hannibal/Canton/Palmyra/Bowling Green operating system within the Northeastern area. That system serves over 14,000 customers, of which approximately 13,000 are residential customers. Natural gas is delivered to this operating system through the Panhandle Eastern Pipeline. (App. pp. A6, A7). The second operating system for which Staff initially proposed a disallowance was the Butler system, within the Western area. It serves approximately 3,700 customers, most of which are residential customers. It also receives natural gas through the Panhandle Eastern Pipeline. (App. p. A7).

The Staff's proposed adjustments of (\$349,015) for the Hannibal area and (\$13,964) for the Butler area related to Atmos' acceptance of the low bids of its affiliate AEM for

the Hannibal and Butler service areas. (L.F. p. 177, Staff Recommendation, Appendix A-1, page 5 of 12).

Atmos filed its response to Staff's recommendation on January 28, 2010. In its Response, the Company disagreed with above-referenced Staff proposed adjustments and requested that the Commission schedule a hearing to deal with the matter. (L.F. p. 188).

Thereafter, the Commission established a procedural schedule whereby Atmos and Staff prefiled direct, rebuttal, and surrebuttal testimony. An evidentiary hearing was held March 23 and 24, 2011. Atmos, Staff and the Office of the Public Counsel filed post-hearing briefs on April 29, 2011, followed by reply briefs on May 20, 2011. (L.F. pp. 1108-1261, 1267-1337).

The Commission issued its Report and Order on November 9, 2011, effective November 19, 2011, wherein the Commission rejected the disallowances proposed by Staff regarding Atmos' transactions with AEM. (App. pp. A-1 - A-33). Public Counsel filed its Application for Rehearing on November 18, 2011, and the Commission issued its Order Denying Application for Rehearing on November 30, 2011. (L.F. pp. 1372, 1374).

Public Counsel filed its Notice of Appeal with the Commission on December 29, 2011 (L.F. p. 1377), and the Clerk of the Western District Court of Appeals acknowledged receipt by correspondence dated January 5, 2012. On January 31, 2012, Atmos Energy Corporation filed its Motion to Intervene as Intervenor-Respondent, and said Motion was sustained by said Court on February 9, 2012. The Western District Court of Appeals issued its decision affirming the Commission's Report and Order in this matter on September 18, 2012, in Case Number WD74714 (2012 WL 4069548).

POINTS RELIED ON

POINT 1

THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER APPROVING THE 2007-2008 ACTUAL COST ADJUSTMENT RATES FOR ATMOS ENERGY CORPORATION SHOULD BE AFFIRMED, BECAUSE IT IS LAWFUL AND REASONABLE WITHIN THE MEANING OF SECTION 386.510, RSMO, IN THAT THE COMMISSION LAWFULLY DETERMINED THAT ATMOS' GAS PURCHASING PRACTICES WERE PRUDENT AND OTHERWISE CONSISTENT WITH THE REQUIREMENTS OF THE AFFILIATED TRANSACTION RULES AND THAT THERE WAS NO RESULTING HARM TO THE COMPANY'S RATEPAYERS, AND THE ORDER IS REASONABLE AS SUCH DETERMINATIONS ARE BASED UPON COMPETENT AND SUBSTANTIAL EVIDENCE ON THE WHOLE RECORD. (RESPONDS TO POINT 1 OF APPELLANT'S POINTS RELIED ON).

Cases

Atmos Energy Corp. v. Office of Public Counsel, 389 S.W.3d 224 (Mo. App. W.D. 2012)

State ex rel. Office of Public Counsel v. Public Service Commission, 289 S.W.3d 240, 246 (Mo. Ct. App. W.D. 2009)

State ex rel. Associated Natural Gas v. Public Serv. Comm'n, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997)

State ex rel. Public Counsel v. Public Service Commission, 274 S.W.3d 569, 577 (Mo. App. 2009)

Regulations

4 CSR. 240-40.015

4 CSR. 240-40.016

ARGUMENT

POINT 1

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**SUBSTANTIAL EVIDENCE ON THE WHOLE RECORD.
(RESPONDS TO POINT 1 OF APPELLANT’S POINTS RELIED
ON).**

1. The Report and Order is Lawful.

A Commission order is presumed valid. *State ex rel. Office of Public Counsel v. Public Service Commission*, 289 S.W.3d 240, 246 (Mo. Ct. App. W.D. 2009). Challengers have the burden to prove it invalid. *Id.* The reviewing court will not substitute its judgment for that of the Commission on issues within the realm of the Commission’s expertise. *Id.* at 247. The record in this proceeding establishes that Atmos was successful in obtaining gas supplies during this ACA period that were reasonable and prudent. In every instance, the Company used a fair and arms-length competitive bid process to solicit, evaluate, and award the contract to the qualified bidder who offered the least cost supply. As detailed below, the Company’s robust, competitive bidding process allowed the opportunity for the Company to obtain numerous proposals from a variety of gas marketers who are in the very competitive market of providing gas supplies to local distribution companies throughout the country. Atmos has been successful in obtaining sufficient gas supplies at market prices by using this competitive process that allows the Company to provide its customers with reliable natural gas at just and reasonable rates.

A. The Prudence Standard.

Simply put, this case is a prudence review. The Commission’s Prudence Standard for PGA/ACA cases is articulated in the seminal case, *State ex rel. Associated Natural*

Gas v. Public Serv. Comm'n, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997) (“*Associated Natural Gas*,” also a PGA/ACA case), which was correctly summarized by the Commission in its Report and Order as follows: “In order to disallow a utility’s recovery of costs from its ratepayers, a regulatory agency must find both that the utility acted imprudently and that such imprudence resulted in harm to the utility’s ratepayers.” (App. p. A21). Rates must be just and reasonable. Section 393.130.1, RSMo (Supp. 2012).

As further noted by the Commission, under the prudence standard, the Commission presumes that the utility’s costs were prudently incurred, but, if some other participant in the proceeding creates a serious doubt as to the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the questioned expenditure to have been prudent (citing *Union Electric*, 27 Mo. P.S.C. (N.S.) 183) (*Id.*). The legal presumption of prudence also applies to affiliated transactions. *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 577 (Mo. App. 2009).

Missouri case law has described the showing necessary to create a serious doubt sufficient to shift the burden back to the utility. In the *Associated Natural Gas* case, the Missouri Court of Appeals held that the Staff must provide evidence that the utility’s actions caused higher costs than if prudent decisions had been made. *See Associated Natural Gas*, 945 S.W.2d at 529. Substantive and competent evidence regarding higher costs includes evidence about the particular controversial expenditures and evidence as to the “amount that the expenditures would have been if the [utility] had acted in a prudent

manner.” *See, Id.* In other words, Staff or the other parties must satisfy the following two-pronged evidentiary test to support a disallowance: 1) identify the imprudent action based upon industry standards and the circumstances at the time the decision or action was made; and 2) provide proof of the increased costs caused by Atmos’ imprudent decisions. To meet this standard, a party must provide substantive, competent evidence establishing a causal connection or “nexus” between the alleged imprudent action and the costs incurred.

B. The Facts of the Case Are Largely Not In Dispute.

Atmos used a formal competitive bidding process to solicit bids from numerous unregulated gas marketers for the Company’s gas supplies in all of its various service areas in Missouri. This formal, competitive bidding process is fully described in the Direct Testimony of Rebecca Buchanan in this proceeding (Ex. 1, Buchanan Direct, pp. 6-14) (Tr. 444), and it is further detailed at pages 8 through 10 of the Commission’s Report and Order. (App. pp. A9 - A11). After a careful evaluation of the various bids received throughout its service area, Atmos awarded eight (8) gas supply contracts to six (6) different gas marketers for its Missouri service areas. (*Id.*).

Two out of eight of its gas supply contracts were awarded to Atmos Energy Marketing (“AEM”), an affiliated gas marketer, which submitted the lowest and best bid for those gas supplies for the Hannibal and Butler areas of the Company during the 2007-2008 ACA period. (Ex. 1, Buchanan Direct, pp. 11-12).

AEM did not win the bid for the other areas of the state which make up about 66% percent of Atmos’ load in Missouri. In these areas, the winning bids went to other

unregulated gas marketers who submitted lower bids than AEM. AEM has not been a dominant gas supplier for Atmos in Missouri. For the period April 2004 through November 2009, Atmos issued forty-eight (48) Missouri RFPs. Of these 48 RFPs, AEM participated in twenty-four (24) RFPs, and AEM was the winning bidder in only 6. Other suppliers who have won multiple times include: BP Energy Company —8 wins; Tenaska--7 wins; Anadarko—7 wins; Centerpoint--5 wins; Conoco Phillips—5 wins, Shell—2 wins, and OGE—2 wins. (*Id.*, at 12).

In this case, Staff did not propose any disallowances related to the gas marketers that submitted the lowest and best bid in the Kirksville, Piedmont/Arcadia, Jackson and other Southeast service areas. In other words, Staff did not propose to disallow any costs associated with AEM's competitors—ConocoPhillips, Centerpoint, BP Energy Company, Anadarko, or Tenaska Marketing.

Staff apparently recognized that Atmos' competitive bidding process produced contracts in these regions that were prudent and reasonable. In these areas, these contracts represented the lowest and best price that was available to Atmos and its customers.

Even though Atmos used the same competitive bidding process for the Hannibal and Butler areas, Staff proposed disallowances in the Staff Recommendation related to the gas supply contracts with AEM, Atmos' unregulated gas marketing affiliate. During the hearings, however, Staff confirmed that it was not asserting that Atmos was imprudent in accepting the lowest and best bid, even though it was from its affiliate. (Tr. 624).

Staff agreed that Atmos is contractually obligated to pay the full amount included in the AEM contracts that were accepted after the formal, competitive bidding process. (Tr. 692) Staff also agreed that the AEM bids were the lowest and best bids available to Atmos and its customers in these areas. (Tr. 645).

The Report and Order and the underlying record reflect that Staff abandoned its original position (Tr. 640), and totally eliminated its proposed disallowance of \$13,764 related to Butler, after it determined that AEM had no gross profits and actually lost money on that transaction. (*Id.*; App. p. A5). It also reduced its proposed disallowance related to the Hannibal area from \$349,015 to \$308,733. (Ex. 28NP, Sommerer Surrebuttal, pp. 18) (Tr. 640) (App. p. A5).

For the Hannibal area, Staff in this case proposed to lower the gas costs that are passed through to consumers by the same amount as the gross profits of AEM on these contracts. (Tr. 640-42). In other words, Staff proposed to disallow from Atmos' gas costs an amount equal to the gross profits earned by AEM on these contracts. Staff's disallowance did not take into account that AEM has administrative overheads—salaries, office costs, and numerous other overheads-- that AEM must recover before it makes any net profit on these transactions. (*Id.*) Staff recognized that their proposed adjustment did not include the personnel costs, and other administrative overheads of AEM. Yet, Staff totally ignored these additional overhead costs in its adjustment. (Tr. 636-37).

In the Hannibal area, if the supply contract had not been awarded to the lowest cost bidder, which happened to be the affiliate, but instead had been awarded to the second place bidder, the annual costs for the Hannibal area customers would have

increased by \$140,000—looking at the two RFP processes used during this ACA period. The record indicates that Staff would have had a concern if the Company had accepted a higher bid from an unaffiliated gas marketer and Staff would have wanted to look at that transaction “in great detail.” (Tr. 645).

Because Atmos tried to save its customers an additional \$140,000 by accepting the lowest and best bids, it faced a disallowance proposed by Staff of \$308,000 and an expensive “forensic audit.” (Tr. 266).

The only difference between the circumstances in the Hannibal service area and in the rest of the Company’s service areas is that AEM happens to be an affiliate of Atmos Energy Corporation, and AEM won the competitive bidding process in the Hannibal and Butler service areas.

It is important to emphasize that AEM is an unregulated gas supplier in competition with numerous other unregulated gas suppliers seeking to win the business of Atmos Energy Corporation in Missouri. AEM is not an agent of Atmos Energy Corporation seeking to obtain gas supplies for Atmos.

C. Atmos Provided No Financial Advantage To AEM.

As fully detailed in its Report and Order, the Commission has a general affiliate transactions rule – 4 CSR 240-40.015 – that establishes regulatory standards surrounding a regulated gas utility’s dealings with its affiliated companies. The Commission also has a marketing affiliate transactions rule – 4 CSR 240-40.016 – that specifically regulates

transactions between regulated gas corporations and affiliated gas marketing companies. (App. pp. A22 – A25) (*See also*, App. A34 – A39).

The general affiliate transaction rule provides:

When a regulated gas corporation purchases information, assets, goods or services from an affiliated entity, the regulated gas corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary or appropriate.⁵

The marketing affiliate transaction rule includes the same language.⁶

The Commission appropriately found that Atmos complied with these rule requirements when it obtained competitive bids before awarding gas-marketing contracts to AEM. (App. p. A26 – A29).

The general affiliate transactions rule further provides:

A regulated gas corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated gas corporation shall be deemed to provide a financial advantage to an affiliated entity if –

1. It compensates an affiliated entity for goods or services above the lesser of –
 - A. the fair market price; or
 - B. the fully distributed cost to the regulated gas corporation to provide the goods or services for itself . . .⁷

⁵ 4 CSR 240-40.015(3)(A).

⁶ 4 CSR 240-40.016(4)(A).

The same language is found in the marketing affiliate transaction rule at 4 CSR 240-40.016(3)(A). (App. pp. A37 – A38).

As fully discussed above, the record clearly established that Atmos followed the Commission’s mandated competitive bidding requirement throughout the ACA period. (Tr. 444-45). It was prudent for the Company to utilize a competitive bidding process to obtain its gas supplies. Perhaps more importantly, the Company believes that this is the best method for securing a reliable source of gas supplies at a reasonable price.

Regarding the provisions of 4 CSR 240-40.015(2)(A), the record of this proceeding clearly establishes that Staff’s entire focus was on the “fair market price” for the gas that AEM sold to Atmos. (See, Tr. 698-699). Indeed, as more fully addressed below, no party suggested that the fully distributed cost to Atmos was lower than the fair market price. (Tr. 698; Ex. 27, Sommerer Rebuttal, p. 11). The Company’s Post-Hearing Brief in this matter (pages 27-32) addressed the applicable case law and evidence regarding “fair market price” in demonstrating that Atmos did not provide its affiliate with a “financial advantage” as defined by the Affiliate Transaction Rule. (L.F. pp. 1135-1142). At the end of the day, having considered the competent and substantial evidence in the record, the Commission agreed with the Company.

As simple as it sounds, fair market price is established by the fair market composed of willing buyers and sellers. In this case, that fair market resulted from the request for bids process undertaken by

⁷ 4 CSR 240-40.015(2)(A).

Atmos to determine the least cost bid for gas marketing services in its various service territories. For some of those service territories, but by no means for all, AEM, a gas marketer affiliated with Atmos, submitted the low bid.

For the service territories in which AEM did not submit the low bid, Staff is willing to accept the fair market price as established by the market. However, for those service territories for which AEM did submit the low bid, Staff claims that it must carefully examine AEM's contracts with its suppliers to determine the real fair market price. It argues that if only it had the full cooperation of Atmos and complete access to the records of the unregulated affiliate, including specific transaction records that the unregulated affiliate does not maintain, it could make such a determination. However, Staff's efforts to determine a "real fair market price" are misguided and doomed to failure.

Fair market price is set by the market, not by Staff's review of documents. Even if Atmos and AEM gave Staff every document they could ever hope to examine they could still never determine a "real fair market price" unless they were able to undertake a full rate case to establish among other things an allowed rate of return for the unregulated gas marketing company; because, as Staff's witness concluded, AEM should be allowed to earn a profit under the proper circumstances. (footnote omitted).

Public Counsel goes one step beyond Staff and argues that AEM, and indirectly Atmos as its corporate parent, should not be allowed to earn a profit on gas transactions because such profits would be contrary to the regulatory principles surrounding Atmos' use of a PGA/ACA mechanism to recover its gas costs. Public Counsel contends that Atmos is capable of controlling its gas costs through its relationship with its affiliate gas marketing company and therefore its use of the PGA/ACA mechanism would constitute single-issue ratemaking under the test established by the Missouri Court of Appeals in *State ex rel. Midwest Gas Users' Assoc. v. Pub. Serv. Com'n.* (footnote omitted).

Public Counsel's argument is incorrect because the cost of gas to Atmos is still controlled by the fair market. **Atmos can award a gas supply contract to its affiliate only if that affiliate submits the low bid for those services. In fact, since the affiliate, AEM, submitted the low bid on these transactions, ratepayers benefit from the affiliate transaction. If Atmos refused to accept the low bid from its affiliate, its ratepayers would have to pay more for gas to their detriment.** (Emphasis added) (App. pp. A27 – A28).

In the Statement of Facts portion of its Brief, Public Counsel focuses on a “discovery dispute” wherein Atmos had objected to two or three data requests (out of over a hundred) which it believed were inappropriate and irrelevant (Tr. 693) and, when a majority of the Commissioners ruled in favor of Staff, Atmos and AEM timely complied

and provided the requested information. At page 13 of its Brief, Public Counsel quotes from the Commission's Order Granting Staff's Motion to Compel Atmos to Respond to Data Requests (L.F. p. 315), attempting to argue and provide support for what it later alleges as an inconsistency in the Commission's decision process. However, Public Counsel fails to inform this Court that after Atmos took exception to the quoted language, it was later clarified by the Commission in a subsequent Order to ensure that "the challenged statement does not indicate that the Commission has prematurely decided the issue of the effect of the bidding process. . . . The statement in the order granting Staff's motion to compel is not binding on the Commission in the ultimate resolution of this case"⁸

D. The Commission Lawfully Construed Its Affiliated Transaction Rule.

Importantly, no party sought to disallow any of Atmos' gas costs based on a fully distributed costs argument. The Commission's findings of fact regarding its decision that Atmos' fully distributed cost of providing gas-marketing services through its own employees would exceed the market price for those gas-marketing services as established by a competitive bidding process among gas marketing companies is fully supported by the expert testimony provided in this case. Indeed, neither the Staff nor the Public Counsel made it an issue in the underlying proceeding. Nevertheless, the Commission's

⁸ (L.F. p. 327), Order Regarding Motion for Reconsideration, Motion for Rehearing and Request for Stay Order, August 4, 2010, p. 3.

Report and Order, devotes eight (8) numbered paragraphs to its analysis and findings regarding this particular area⁹:

10. Atmos uses the services of independent gas marketing companies to purchase its natural gas because it does not have the in-house expertise needed to perform the gas marketing services provided by those companies. (footnote omitted).

11. If it were to undertake its own marketing services using its own, in-house employees, Atmos would need to hire or train additional personnel at a substantial cost and develop processes already used by independent gas marketers to secure gas supplies and transport gas through the interstate gas pipeline system. (footnote omitted).

12. In-house gas marketing employees would still need to negotiate and contract for the purchase and transport of natural gas supplies. The price of gas and the cost to transport that gas would still be determined by market forces, just as those prices are determined by market forces when they are purchased by independent marketing companies. (footnote omitted).

13. Most importantly, Atmos is a natural gas distribution company. Its core competency is in the distribution of natural gas to its customers. It is able to most efficiently provide service to its customers by focusing on that core competency while leaving gas marketing services to gas marketing companies that specialize in providing that service. (footnote omitted).

⁹ (App. pp. A7 – A9).

14. On the basis of those facts, Atmos contends that its fully distributed cost of providing gas-marketing services through its own employees would exceed the market price for those gas-marketing services as established by a competitive bidding process among gas marketing companies. (footnote omitted).

15. Staff does not challenge the specifics of Atmos' decision to purchase its gas supplies through gas marketing companies rather than by using in-house gas marketing experts except to insinuate that it is "most remarkable that the 'largest natural-gas-only distributor in the United States' (per the Company's website) asserts that it does not have the resources to optimize PGA assets. (footnote omitted).

16. **Furthermore, Staff does not seek to disallow Atmos' costs associated with acquiring its gas supply through the services of unaffiliated gas marketing companies. And Staff does not seek to disallow any of Atmos' gas costs based on a fully distributed costs argument.** Thus, it is apparent that Staff's only concern is only with Atmos' affiliated transactions and not with Atmos' decision to obtain its gas supplies through gas marketing companies rather than by purchasing those supplies using in-house gas marketing personnel. (footnote omitted) (emphasis added).

17. The Commission finds that Atmos' fully distributed cost of providing gas-marketing services through its own employees would exceed

the market price for those gas-marketing services as established by a competitive bidding process among gas marketing companies. (footnote omitted).

At each point in the proceeding when the Staff's subject matter expert was asked specifically about the Staff's position regarding the affiliate transaction rule's fully distributed costs provision, he confirmed that Staff did not seek to disallow any of Atmos' gas costs based on a fully distributed costs argument. At the October 20, 2010 oral argument regarding the discovery motion, Staff Witness David Sommerer testified as follows in response to an inquiry from Commissioner Jarrett:

[Mr. Sommerer]: In this case we did look at the Company's responses to data request and their testimony with regard to fully distributed cost. The Company made statements saying that the fully distributed cost when you realize that individuals in Houston are procuring the supply, there are overheads involved in the procurement of that supply. And we have a definition here in the rule what fully distributed cost is.

It's, you know, from the perspective of the LDC to produce the goods themselves. If you're not producing wellhead supply, you're not making it, it's not around in Hannibal. This is not a producer here, so you're looking at sort of a wholesale cost and clearly the fully distributed cost includes direct and indirect cost that might be allocated pursuant to general and administrative.

The Company's testimony is is that – well, you've got a wholesale price. If you layer in or you load indirect cost and administrative costs, almost by definition, you're looking at something higher than the fair market value price.

So you know, we inquired into what the Company's view of fully distributed cost and **for purposes of this case – and I won't say this universally, but for the purposes of this case – I understand that argument and to me the Staff's position is not a concern about fully distributed cost being less than the fair market value price.** (Tr. 197-198) (Emphasis added).

Again, in response to a question from Atmos counsel during the evidentiary hearing, Mr. Sommerer reiterated the Staff position on this issue:

Q. [by Mr. Fischer]: And Staff has attempted to ascertain the fair market value or the fair market price of the gas purchased by Atmos from AEM in this case. Right?

A. [by Mr. Sommerer]: Correct.

Q. According to your rebuttal testimony, Staff has not focused on the fully distributed costs in this case. Right?

A. Correct.

Q. And I believe in the October 20 hearings in this case, you indicated that there was no adjustment proposed by Staff based upon fully distributed cost to Atmos. Right?

A. That's correct. (Tr. 698).

Public Counsel offered no witnesses in this proceeding. The only testimony offered regarding this subject clearly supports the Commission's decision.

Regarding OPC's alleged lack of documentation of costs, Commissioner Jarrett again inquired of Staff during the October 20, 2010 oral argument:

Commissioner Jarrett: Okay. And then (B) goes on to say – (3)(B) [referring to 4 CSR 240-40.015]: In transactions that involve either the purchase or receipt of information, assets, goods or services, by a regulated gas corporation from an affiliated entity, the regulated gas corporation shall document both the fair market price of such information, assets, goods and services and the fully distributed cost to the regulated gas corporations to produce the information, assets, goods or services for itself.

Did the Company do those things?

Mr. Berlin (Staff Counsel): I believe that it did. (Tr. 199-200).

The Commission appropriately addressed the only “record-keeping” allegations that had been raised by the Staff (and, thus, by OPC) in its Report and Order:

K. Both the general and specific affiliate transaction regulations impose record-keeping requirements on the (sic) both the regulated gas company and its affiliates. The relevant portion of the regulations states:

Each regulated gas corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated gas corporation;
2. Documentation of the methods used to allocate and/or share costs between affiliated entities, including other jurisdictions and/or corporate divisions;
3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions; . . . (Footnote 83: 4 CSR 240-40(5)(A). The rule goes on to list further record keeping requirements that are not related to the issues in this case. The same language is found in the Marketing Affiliate Transaction rule at 4 CSR 240-40.016(6)(A)).

L. Staff and Public Counsel complain that Atmos and its affiliate, AEM, have failed to comply with the record-keeping requirements of the regulations **in that AEM failed to provide Staff with records sufficient to allow Staff to determine the fair market value of gas supply costs charged to Atmos.** (Footnote 84: Transcript, Page 731, Lines 7-17. See also, Staff's Initial Brief, at Page 19). (Emphasis added).

M. However, the record-keeping requirements cited by Staff and Public Counsel do not require AEM to keep records sufficient to allow Staff to determine the fair market value of gas supplies charged to Atmos,

because no such gas supply costs have been charged to Atmos within the meaning of the regulation.

N. The record-keeping requirements cited by Staff and Public Counsel apply to records of affiliated entities concerning the allocation of common costs among the affiliated companies. For example, an affiliate may share an accountant with the regulated utility and some portion of the cost of employing that accountant may be charged to the regulated utility. Those record-keeping requirements do not contemplate a situation where an affiliated company has simply sold a product to the regulated entity at a fair market price determined through an above-board, competitive bidding process.

O. **In fact, Staff’s witness indicated he was unaware of any provision in the Commission’s rules that would require AEM, or any other affiliate, to maintain records sufficient to allow Staff to determine the affiliate’s net profits on a transaction by transaction basis.** (Footnote 85: Transcript, Page 635, Lines 17-21.). (Emphasis added).

(App. pp. A24 – A25).

2. The Report and Order Is Reasonable.

If the Commission’s order is found to be lawful, the reviewing court must then determine whether it is reasonable. A PSC order is reasonable ““where the order is supported by competent evidence on the whole record; the decision is not arbitrary or

capricious [;] or where the [PSC] has not abused its discretion.”” *State ex rel. Praxair, Inc. v. Missouri Pub. Serv. Comm’n*, 344 S.W.3d 178, 184 (Mo. Banc 2011), quoting *Envtl. Utils., LLC v. Pub. Serv. Comm’n*, 219 S.W.3d 256, 265 (Mo. App. 2007).

A. The Commission’s Decision Is Supported by Competent and Substantial Evidence On The Whole Record, Is Neither Arbitrary or Capricious, Nor Has the Commission Abused Its Discretion.

A Commission order is presumed valid. *State ex rel. Office of Public Counsel v. Public Service Commission*, 289 S.W.3d 240, 246 (Mo. Ct. App. W.D. 2009). Challengers have the burden to prove it invalid. *Id.* The reviewing court will not substitute its judgment for that of the Commission on issues within the realm of the Commission’s expertise. *Id.* at 247.

Contrary to Public Counsel’s assertions in its Brief to this Court, there was ample competent and substantial evidence to support the Commission’s decision that Atmos’ gas purchasing practices were prudent and otherwise consistent with the requirements of the affiliate transaction rules during this ACA period. As fully discussed above, both subject matter experts offering testimony on the issue of fully distributed costs – one for the Company, the other for the Staff – supported the Commission’s findings and conclusions regarding the issue. The determination of witness credibility is solely within the discretion of the Commission, which is free to believe none, part, or all of a witness’s testimony. *State ex rel. Missouri Office of the Public Counsel v. Public Service Commission of Missouri*, 293 S.W.3d 63, 69 (Mo. App. S.D. 2009).

Company Witness Rebecca Buchanan, a certified public accountant, has been employed with Atmos and its predecessor for nearly twenty (20) years, serving for over three and a half years as Manager, Regional Gas Supply with responsibilities for seven states. (Tr. 338-339). Staff Witness David Sommerer, who addressed and confirmed Staff's position that it did not seek to disallow any of Atmos' gas costs based on a fully distributed costs argument, *supra*, has been performing or supervising PGA and ACA reviews for more than 20 years. The following exchange between Commissioner Davis and Mr. Sommerer during the October 20, 2010 oral argument, reflects Mr. Sommerer's background:

Q. [Commissioner Davis] Okay. Now Mr. Sommerer, going back and looking at your direct testimony pages 1 through 3 in your scheduled DMS 1-1, you've been performing or supervising PGA and ACA reviews for more than 20 years. Correct?

A. [Mr. Sommerer] That's correct.

Q. So you're intimately familiar with the process?

A. Yes.

Q. And your duties as manager of the procurement analysis department require you to be familiar with the – what's commonly referred to as the Affiliate Transaction Rule as well as the Market Affiliate Rule?

A. Yes.

Q. So you are familiar with those rules?

A. Yes.

(Tr. 110).

Attempting to find any evidentiary support for its fully distributed costs argument, Public Counsel cites in its Brief what the Commission refers to as the “insinuation” of the Staff witness’ observation regarding the possible capabilities of the largest natural-gas-only distributor. However, the Commission squarely addressed even this random observation in its Report and Order:

Staff does not present any serious argument to suggest that Atmos could provide gas-marketing services for itself cheaper if it did not use the services of gas marketing companies. Staff’s witness threw out some statements suggesting that a big company like Atmos should have the resources to purchase gas for itself, **but when pressed, he conceded that Staff was not proposing any adjustment based on the company’s fully distributed cost.** (Footnote 89: Transcript, Page 698, Lines 10-14).

Furthermore, Staff did not propose any disallowance relating to the gas supply contracts that Atmos awarded to non-affiliated gas marketing companies after following the same request for proposal process. If it is less expensive for Atmos to purchase gas supplies through non-affiliated gas marketing companies than to maintain its own staff of gas buyers, then there is no basis to believe that it should maintain such a staff of buyers only to avoid awarding a contract to its affiliated marketing company when that company happens to submit a bid lower than the bids submitted by the unaffiliated companies. . . . (Emphasis added).

(App. pp. A26 – A27).

The Commission is afforded the benefit of reasonable inferences that may be drawn from the facts. *State ex rel. Noranda Aluminum, Inc. v. Public Service Commission of Missouri*, 356 S.W.3d 293, 297 (Mo. App. S.D. 2011). The reviewing court does not reweigh the evidence. *State ex rel. Office of Public Counsel v. Public Service Commission*, 293 S.W.3d 68, 80 (Mo. Ct. App. S.D. 2009). Factual findings will not be disturbed if they are supported by the record. *Id.* The Commission based its decision on competent and substantial evidence and, accordingly, the decision is not arbitrary, capricious, nor an abuse of the PSC’s discretion.

B. The Commission’s Decision Is Based On All Relevant Factors.

Citing the *Midwest Gas Users’* case,¹⁰ Public Counsel asserts that the Commission did not consider all relevant factors in reaching its decision. To the contrary, and as reflected in the portions of the Report and Order quoted herein, a review of the unanimous, extensive decision and the breadth of citations to the underlying record, clearly reveals that the Commission carefully considered all issues placed before it and considered all relevant factors in resolving those issues. Public Counsel’s summary argument regarding an insufficient evidentiary record fails.

C. The Commission Applied the Correct Presumption Of Prudence Standard That Has Been Approved by the Courts in Missouri in Affiliate Transaction Cases.

¹⁰ *Midwest Gas Users’ Association v. P.S.C.*, 976 S.W.2d 470, 483 (Mo. App. 1998).

The Public Counsel erroneously suggests that ‘No Missouri court has specifically addressed the whether the prudence presumption is appropriate for affiliate transactions, and the Western District Court of Appeals Opinion in this case relies heavily upon that presumption in affirming the PSC’s Report and Order. . . . There are no Missouri cases directly on point to provide an analysis of whether the presumption of prudence should apply to affiliate transactions.’ (Appellant’s Br. at 34-35).

As an initial matter, it is inappropriate for the Public Counsel to raise this issue on appeal since it has not been raised previously before the Commission or in Public Counsel’s Motion For Rehearing in this case. Section 386.500.2 RSMo. An argument that has not been raised before the Commission in a motion for rehearing cannot be raised for the first time on appeal. *State ex rel. Kansas City Transit, Inc. v. Public Service Commission*, 406 S.W.2d 5, 7 (Mo. Banc 1966); *State ex rel. City of West Plains v. Public Service Commission*, 310 S.W.2d 925, 934 (Mo. Banc 1958); *State ex rel. Beaufort Transfer Co. v. Clark*, 504 S.W.2d 216, 220 (Mo. App. W.D. 1973). Even if the Court determines that this point of error was raised in Public Counsel’s motion for rehearing, it should be rejected on the merits.

Contrary to the position of Public Counsel, the prudence standard that the Commission applies in PGA/ACA proceedings was approved in *Associated Natural Gas Co.*, 954 S.W.2d at 532. The transaction being examined in *Associated Natural Gas* was

an affiliate transaction that was reviewed in a PGA/ACA proceeding. *Id.* at 522.¹¹ This case was decided in 1997, after the restructuring of the natural gas market. *Id.* at 527. The Court still found that it was appropriate for the Commission to presume that the utility had acted prudently. *Id.* at 529-30. Contrary to Public Counsel's argument, the fact that the natural gas market has changed since the introduction of the PGA mechanism in the 1960s is an insufficient reason to alter the prudence standard used to examine natural gas purchases that has been previously approved by the Courts, or to remove the presumption of prudence from the analysis.¹²

The Court of Appeal's discussion of the prudence standard in the current case concludes with the following citation: **"The prudence standard applies to affiliate transactions.** *Public Counsel*, 274 S.W.3d at 577." (*Office of Public Counsel v.*

¹¹ The presumption of prudence has also been utilized by the Commission in other public utility cases since its decision in 1985 in *Re Union Electric Company*, Case No. EO-85-17, 27 Mo. P.S.C. (N.S.) 183, 66 P.U.R.4th 202, 212-13 (March 29, 1985); *See also Re Kansas City Power & Light Co.*, Case No. ER-85-185, 75 P.U.R.4th 1, 51 (April 23, 1986); *Re: Kansas City Power & Light Co.*, Case No. ER-2010-0355; 2011 WL 1525703, ** 27-28 (April 12, 2011). The presumption of the prudence of utility expenditures is a fundamental and long standing tenet of Missouri regulation of public utilities that should not be overturned in this proceeding.

¹² For a history of the restructuring and history of natural gas regulation, see *Midwest Gas Users' Assoc. v. Public Service Commission*, 976 S.W.2d 470, 472-75 (Mo. App. 1998).

Missouri Public Service Comm’n, 2012 WL 4069548, *3, emphasis added) (App. p. A56). Indeed, the Court of Appeals specifically discusses its 2009 decision in *Public Counsel*, noting that it “recently reviewed the similar issue of whether an unregulated affiliate of an electric company was required to sell its services to its regulated affiliate utility at its cost without earning a profit. *See Public Counsel*, 274 S.W.3d at 582.” (*Id.* at *7) (App. A58):

. . . In this case, the OPC cites no cases holding that a utility acts imprudently in transacting business with its affiliate simply because the affiliate earns a profit on the transaction. Indeed, restricting an affiliate’s ability to earn a profit could ultimately deprive a utility of the best price where the affiliate, which otherwise would have submitted the lowest bid, decides not to sell to the utility. As a regulated utility, Atmos certainly had an obligation to obtain natural gas for its Hannibal/Bowling Green service area at the lowest prudent cost. It also had an obligation to engage in fair dealing with its affiliate. It did so by buying the gas from AEM, who offered the best bid for reliable supply at the least cost to the benefit of the ratepayers. (*Id.*)

See also GS Technologies Operating Co. v. Public Service Commission, 116 S.W.3d 689 (Mo. App. 2003); *AG Processing, Inc. v. KCP&L Greater Missouri Operations Co.*, 385 S.W.3d 511 (2012). Public Counsel’s reliance on case law from other jurisdictions is not persuasive in light of the controlling Missouri case law.

The PSC and the Court of Appeals in this case correctly and lawfully applied the prudence standard in this matter that has previously been approved by the Courts in Missouri.

Although Atmos purchased its gas supply for its Hannibal/Bowling Green service area from its affiliate AEM, the PSC properly presumed that Atmos was prudent in the purchase until the Staff or OPC presented evidence that raised a serious doubt concerning the prudence of its expenditures. *Public Counsel*, 274 S.W.3d 578; *Associated Natural Gas*, 954 S.W.2d at 528. The Staff and the OPC failed to raise a serious doubt about the prudence of the transactions. (*Office of Public Counsel*, *5) (App. A57).

Even if a utility has acted imprudently, it is not enough under *Associated Natural Gas* to simply establish the imprudence. *Associated Natural Gas Co.*, 954 S.W.2d at 529-30. It must also be established that the imprudence caused actual harm to the ratepayers. *Id.* In the absence of harm, there is no basis for disallowance of costs. *Id.* Public Counsel completely disregards this second element of the prudence standard upheld in *Associated Natural Gas*. The record in the Commission proceeding establishes that there was no harm to Atmos ratepayers in this case. In fact, Atmos ratepayers paid less for gas under the contract with the affiliate supplier AEM than they would have paid if Atmos had accepted any of the bids submitted by unaffiliated suppliers. Public Counsel's claim fails for this additional reason.

Appellant takes issue with the PSC's underlying analysis regarding the competitive bidding process Atmos used to obtain its Missouri gas supply. However, as the PSC (*see Office of Public Counsel* at *6) (App. A58) and the Court of Appeals appropriately determined, "Because of the competitive bidding process, which is required by 4 CSR 240-40.016(4)(A), Atmos paid less for gas marketing services provided by AEM than it would have paid for the same services provided by a non-affiliate company for its Hannibal/Bowling Green service area. Nothing in the record indicated that Atmos tended to favor its affiliate in the bidding process. And the Staff and OPC did not raise a serious doubt about the fairness of the bidding process." (*Office of Public Counsel* at *7) (App. p. A58). It is important to emphasize that AEM is an unregulated gas supplier in competition with numerous other unregulated gas suppliers seeking to win the business of Atmos Energy Corporation in Missouri. In many cases, other gas suppliers have prevailed in the bidding process. As discussed above, AEM is not an agent of Atmos Energy Corporation seeking to obtain gas supplies for Atmos.

CONCLUSION

WHEREFORE, for the above reasons, Respondent Atmos Energy Corporation prays that the Court affirm the Report and Order of the Commission in this matter, and requests such other relief that the Court deems just and proper.

Respectfully submitted,

/s/ Larry W. Dority

Larry W. Dority, MBN 25617

James M. Fischer, MBN 27543

FISCHER & DORITY, P.C.

101 Madison Street, Suite 400

Jefferson City, MO 65101

Telephone: (573) 636-6758

Facsimile: (573) 636-0383

Email: lwdority@sprintmail.com

Email: jfischerpc@aol.com

Douglas C. Walther, MBN 32266

Deputy General Counsel

Atmos Energy Corporation

5430 LBJ Freeway

1800 Three Lincoln Centre

Dallas, Texas 75240

Telephone: (972) 855-3102

Facsimile: (972) 855-3080

Email: Douglas.Walther@atmosenergy.com

ATTORNEYS FOR RESPONDENT
ATMOS ENERGY CORPORATION

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the above and foregoing document was served by means of electronic filing on this 28th day of March, 2013, to the following:

Jennifer Heintz
Missouri Public Service Commission
200 Madison Street
Suite 100
P.O. Box 360
Jefferson City, MO 65102
Jennifer.heintz@psc.mo.gov

Marc Poston
Deputy Counsel
Missouri Office of the Public Counsel
P.O. Box 2230
200 Madison Street
Jefferson City, MO 65102
Marc.poston@ded.mo.gov

/s/ Larry W. Dority
Larry W. Dority
Attorney for Respondent
Atmos Energy Corporation

CERTIFICATE OF COMPLIANCE PURSUANT TO RULE 84.06(c)

I hereby certify that the foregoing Brief includes the information required by Rule 55.03, that the Brief complies with the limitations contained in Rule 84.06(b) and, according to the word count of the word-processing system used to prepare this Brief (excepting therefrom the cover, certificate of service, this certificate, signature block and appendix), it contains 9,006 words.

/s/ Larry W. Dority

Larry W. Dority, MBN 25617

FISCHER & DORITY, P.C.

101 Madison Street, Suite 400

Jefferson City, MO 65101

Telephone: (573) 636-6758

Facsimile: (573) 636-0383

E-mail: lwdority@sprintmail.com